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Newsletter
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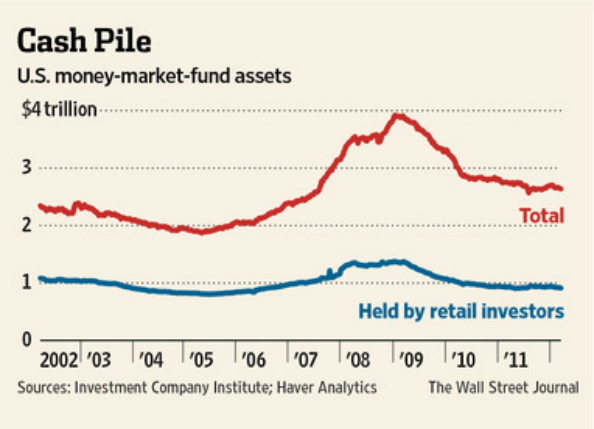
April 1st, 2012

Much Ado About Nothing?
A Discussion of Money Market Funds

Ms. Mary Shapiro, Chairman of the SEC, has proposals on the table to restructure the often misunderstood money fund industry. But how much money sits in money-market funds (Chart 1) and what are the risks? And what form would the restructuring take?

Chart 1



As you can see in Chart 1, investors hold more than $2.7 trillion dollars in money market funds. Money-market funds (MMF's) are often perceived as a cash equivalent. Money-market funds, however, are actually mutual funds that hold investments in short-term debt securities, and they are not explicitly guaranteed by their sponsors. For instance, the top holdings for Schwab's Money Market Fund (SWMXX) dated 12/31/11are listed in Chart 2 below. Up to this point, MMF's have always been priced at $1 per share, giving the impression that they are as safe as the cash you hold in bank accounts. While this perception is not exactly true, the set price does force sponsors of MMF's to shore up the price, subsidizing losses if the value of the underlying securities falls to less than one dollar, known as "breaking the buck."

When Lehman collapsed in September of 2008, the Reserve Fund "broke the buck," triggering a panic across money market holders. A 2010 Moody's Investors Service report showed that while only one fund broke the buck during the financial crisis; 62 funds, including 36 in the U.S., received financial and balance-sheet support from their sponsor or parent company[1]. Chart 1 illustrates the drawdown that occurred as a result of this event. To avoid a "run on the banks," the Federal Reserve and the U.S. Treasury temporarily issued guarantees to keep the value of all money market funds at $1. This guarantee expired in September of 2009.

Chart 2

Top 10 Holdings (Issuer, Effective Maturity Date)	% of Net Assets
Credit Suisse Securities (USA), LLC, 01/03/2012	3.6%
BNP Paribas Securities Corp, 01/03/2012	2.3%
Barclays Capital, Inc, 01/03/2012	1.5%
Merrill Lynch, Pierce, Fenner & Smith, Inc, 01/03/2012	1.5%
Royal Bank of Canada, 01/03/2012	1.2%
Deutsche Bank Securities, Inc, 01/03/2012	1.2%
Barclays Capital, Inc, 01/03/2012	1.1%
Commonwealth Bank of Australia, 01/27/2012	1.1%
Deutsche Bank Securities, Inc, 01/06/2012	1.0%
UBS Securities LLC, 01/06/2012	1.0%
TOTAL	**15.3%**

As a result of the liquidity squeeze that presented itself in 2008, the SEC, in 2010, overhauled the money market fund rules, requiring more cash holdings in order to pay out "reasonably foreseeable redemption

[1] WSJ 02.24.12 by Andrew Ackerman "SEC Chairman Amplifies Call for Money-Market Revamp"

requests." Additionally, they tightened the credit quality requirements for holdings in MMF's. Opponents of further restructuring, which includes some of the SEC commissioners, maintain that these changes should be given more time to work. Ms. Mary Shapiro, SEC Chairman, believes that these changes do not go far enough. The SEC has clearly stated that, if a repeat of 2008 happened, they would not have adequate tools at their disposal to be able to guarantee the MMF's again.

Two proposals have been suggested to prevent destabilizing runs in the future.

1. Require money funds to post floating unit values, rather than always trading at one dollar. This would clearly remind all investors that they hold a mutual fund security.
2. Require money funds to maintain bank-like capital buffers. Also, investors who wish to sell all of their holdings would be allowed to receive only 95% to 97% of their cash back immediately. The remaining funds would be returned to them after 30 days. The goal of this holdback is to make sure that fleeing shareholders do not damage the value of the MMF for the remaining shareholders.

The opponents to these additional changes voice the following concerns.

1. Reduction of already low returns
2. Damage to consumer confidence in the investment
3. Accounting changes because new regulations would make money funds a balance sheet item, clouding financial results and changing the leverage equation.

How might this conundrum best be solved? It seems obvious that investors MUST be better informed that money funds are indeed mutual funds with underlying securities determining their value. Banks should market these products with the caveat that there is no backstop and that losses are possible. If they are loathe to do that, then they can act as the backstop for these funds and put them onto their balance sheets. Either way, it seems that fundamental changes are in store for investors of money market funds.

Investors should pay close attention to the types of securities held in their money funds, just as they do when they research any mutual fund. They should also be aware of whether their account holds their "cash" in actual cash or in a money market fund. Custodians offer many different types of funds with specific underlying securities. U.S. Treasury money market funds do not face the counterparty risk that MMF's with various global income securities face.

All of these variations of MMF's are being more clearly articulated and labeled by all broker/dealer custodians. Kudos to the SEC Chairman for rightly pointing out that the risks inherent in money market funds are often misunderstood. We are hopeful that the restructuring process will enhance the public's understanding of the investments held in money market funds and confirm the viability of this very important investment vehicle to all of us.

- Rachel Wakefield, CFA